

82-1878

Office Supreme Court, U.S.
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MAY 19 1983
ALEXANDER L. STEVAS,
CLERK

No. _____

IN THE SUPREME COURT OF THE UNITED STATES

Term: October, 1982

EDWARD DAVID, Petitioner,

vs.

UNITED STATES, Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Mohney, Goodrich & Titta, P.C.
By Robert D. VanderLaan
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Attorneys for Petitioner

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

To the Honorable, the Chief Justice
and Associate Justices of the Supreme
Court of the United States.

Edward David, the petitioner herein,
prays that a Writ of Certiorari issue to
review the judgment of the United States
Court of the Appeals for the Sixth
Circuit, entered in the above-entitled
case on March 25, 1983.

QUESTIONS PRESENTED

Did the Government, in a criminal tax fraud investigation based upon the net worth method of proof, fail to conduct a full and adequate investigation, and did the Government fail to follow reasonable leads concerning the opening inventory value of petitioner's business?

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit is reported at (not reported) and is printed in Appendix A, hereto, infra, page A-1. The judgment of the United States Court of Appeals for the Sixth Circuit is printed in Appendix A hereto, infra, page A-18. The journal of entry of judgment of the United States District Court for the Western District of Michigan, Southern Division, is printed in Appendix A hereto, infra, page A-21.

JURISDICTION

The judgment of the United States Court of Appeals for the Sixth Circuit (Appendix A, *infra*, page A-18) was entered on March 25, 1983. A timely petition for rehearing was denied on March 17, 1983 (Appendix A, *infra*, page A-20). The jurisdiction of the Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL PROVISIONS

The Fifth Amendment to the Constitution of the United States of America:

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

STATEMENT OF THE CASE

Petitioner was convicted after a jury trial in the United States District Court for the Western District of Michigan, Southern Division, on all counts of a six count Indictment of income tax evasion for the years 1974, 1975 and 1976 under 26 U.S.C. §7201 and subscribing to a false tax return for the same years under 26 U.S.C. 7206(1). Petitioner contends that the Government, in adopting a net worth method of proof for income tax fraud purposes, failed to conduct any investigation or follow reasonable leads concerning the value of petitioner's opening business inventory.

At the conclusion of the Government's case, petitioner moved, pursuant to the case of Holland v United States, 348 U.S. 121 (1954), for a judgment of acquittal which was denied. The trial court ruled that whether the efforts of the Govern-

ment regarding the establishment of opening inventory were reasonable was a factual question for the jury to determine.

The same issue regarding the Government's conduct of investigating leads with respect to the opening inventory of petitioner's business was raised with the United States Court of Appeals for the Sixth Circuit, which affirmed the petitioner's conviction.

The Supreme Court in the Holland case laid down as an essential condition in a net worth case the establishment, with reasonable certainty, of an opening net worth to serve as a starting point from which to calculate future increases in a taxpayer's assets. The Supreme Court in Holland ruled that since the use of the net worth method involved something more than ordinary use of circumstantial evidence in the usual criminal case and

that careful study indicated that the use of the net worth method is so fraught with danger for the innocent, that the courts must closely scrutinize its use.

In this case, petitioner did not keep account of his inventory. The Government, in its net worth analysis, used "0" or "dash" for the opening year of 12/31/73 and \$99,858.86 for the close of 12/31/74, resulting in an increase in net worth of \$99,858.86 for 1974. The total claimed understatement of taxable income for 1974 was \$165,164.92 and any beginning inventory would have reduced such understatement dollar for dollar and the excess carried over to reduce the claimed 1975 and 1976 understatement of income.

The investigation of the Government completely ignored opening inventory. This was because the Government's initial audit was based upon a specific items method of analysis, not the net worth

method. The specific items method was based upon establishing an understatement of income based upon specific transactions not being reported. The specific items audit method did not require an opening inventory.

The Government changed its audit method to the net worth method when the special revenue agent entered the case but nothing thereafter was done by the Government to investigate or establish Petitioner's opening inventory. The special agent never mentioned opening inventory to petitioner or asked for opening inventory records, and the Government did nothing to investigate opening inventory other than to determine that petitioner had leased warehouse space for his inventory. The determination of such opening inventory was relevant, susceptible to being checked and could have found Petitioner guiltless of the alleged tax crimes.

ARGUMENT

Petitioner respectfully submits that the opinion of the United States Court of Appeals for the Sixth Circuit and District Court decision at trial are both in conflict with the decision of the United States Supreme Court in Holland v United States, supra.

Petitioner submits that the opinion of the United States Court of Appeals for the Sixth Circuit affirming the decision of the Federal District trial court is plain error, and such serious error as to substantially confuse the case law which has developed on the basis of the Holland decision.

Further, the opinion of the Sixth Circuit is in conflict with the Ninth Circuit in the case of United States v Hall, 650 F2d 994 (1981); the Fifth Circuit in the cases of United States v Dvoskin, 644 F2d 418 (1981) and United States v Boulet, 577 F2d 1165 (1978), the

Seventh Circuit in the case of United States v Shavin, 320 F2d 308 (1963).

The correct analysis of the test laid down by the Supreme Court in the Holland case was most recently set forth in the case of United States v Lenamond, 553 F. Supp. 852 (N.D. Tex. 1983).

In the instant case, the trial court ruled that the question of adequacy of the Government's investigation of petitioner's opening inventory was a question for the jury.

The opinion of the United States Court of Appeals for the Sixth Circuit indicated that the Government made a "good faith" effort to establish opening inventory and it was petitioner's failure to keep accurate business records which prevented the Government from obtaining an accurate evaluation of opening inventory as of 12/31/73. Such analysis

and decision in effect shifts the burden of proof from the Government to the petitioner, which the Supreme Court in the Holland case specifically rejected:

The Government must still prove every element of the offense beyond a reasonable doubt though not to a mathematical certainty. The settled standards of the criminal law are still applicable to net worth cases just as to prosecutions for other crimes.

Id. at 138.

In this case, the Government never asked petitioner for his opening inventory, and never did anything other than determine that he leased warehouse space for his inventory. The Government completely ignored opening inventory due to its original audit method and conducted no investigation nor followed any leads when it changed to the net worth audit method. The cases cited by the United States Court of Appeals for the Sixth Circuit in support of its opinion

are civil, not criminal cases, with the exception of United States v Stone, 531 F2d 939 (8th Cir. 1976). The Stone case is dissimilar and actually supports the appeal and position of petitioner because the Government had investigated leads supplied by the taxpayer by determining the amount and approximate value of the taxpayer's inventory at the beginning of the period in question.

All of the Government's inventory investigations only concerned the later years ending 1974, 1975 and 1976. Nothing was ever done to investigate or follow leads regarding opening inventory as of 12/31/73, and there is no basis for the "good faith" conclusion of the United States Court of Appeals for the Sixth Circuit. To allow this decision to stand will substantially confuse the standards of conduct allowed the Government in utilizing the net worth method in

criminal tax fraud investigations, and shift the burden of proof from the Government to the taxpayer where the taxpayer's records are not available.

CONCLUSION

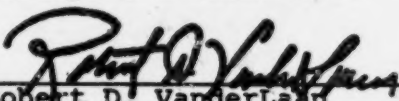
For the foregoing reasons, the
Petition for a Writ of Certiorari should
be granted.

DATED: May 18, 1983

Respectfully submitted,

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Attorneys for Petitioner

By


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before citing in a proceeding in a court
in the Sixth Circuit. If cited, a copy
must be served on other parties and the
Court. This notice is to be prominently
displayed if this decision is reproduced.

No. 82-1493

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

EDWARD DAVID,

Defendant-Appellant.

Filed: January 27, 1983

Before: KENNEDY AND WELLFORD,
Circuit Judges; and BROWN, Senior Circuit
Judge.

KENNEDY, Circuit Judge. Edward David
appeals from a jury conviction for tax
evasion. Appellant contends that the
government's failure to establish opening

Defendant shall pay a Fine to the United States in the sum of Forty-Five Thousand Dollars (\$45,000.00).

The Fine shall be suspended if, within 30 days defendant shall remit to the Clerk of the Court \$45,000.00 which as the Court directs shall be placed in an interest bearing account to be used in a program which assists ex-offenders with job training. This \$45,000.00 shall not be used by the defendant as a tax deduction.

Defendant shall make a good faith effort to make a civil settlement with the Internal Revenue Service and pay the taxes found to be due. As to the amount due, defendant must enter into good faith negotiations with the Internal Revenue Service to reach a settlement.

Signed by U.S. District Judge Douglas W. Hillman.

Date: July 8, 1982.

inventory undermined the basic integrity of the net worth calculations it relied upon to establish "a tax due and owing" for the years 1974, 1975 and 1976. For the reasons set forth below, we affirm the conviction.

Appellant is a well education businessman who was engaged as a sole proprietor in business both as a broker and as a distributor of food and non-food products. His brokerage business was known as the Ed David Company. Through it he earned commissions paid by producers on the sale of their products to retailers, primarily supermarket chains within a designated market area. Appellant's distributorship business was known as Battery Power Distributing Company, and through it he took title to Ray-O-Vac batteries which he would then sell to Meijer's markets for a profit. Appellant and Meijer's had a falling-out

sometime in late 1973. Appellant continued doing business for a period of time during 1974 as a distributor to the Kroger Company under the name Battery Power Distributing Company, but later changed to the assumed name of Solar Sales.

Appellant testified that he set up Solar Sales in collaboration with the head buyer for the Kroger Company to allow appellant to distribute outside his given market area in exchange for kickbacks paid to the head buyer. The head buyer denied ever taking kickbacks but appellant and his wife testified that sales receipts were deposited in the account of the Ed David Company and the head buyer was paid off in cash.

Although appellant testified that he stopped doing business under the name Battery Power sometime in 1974, he testified that he still ordered goods in

the name of Battery Power during 1974, 1975 and 1976. Those goods were stored in warehouse space which Battery Power leased at two locations: (1) space subleased from Meijer's on a month-to-month basis, and (2) space leased in a converted gypsum mine known as Michigan Natural Storage.

From 1964 through 1978, appellant retained George DeVries, Certified Public Accountant, to prepare his income tax returns. DeVries died in the summer of 1979, about the time when the IRS began its investigation, and, as a result, DeVries never worked with the IRS. Appellant asserts this as a disadvantage to his case, but the testimony of Mr. Saurman, an accountant in the DeVries firm, established that after Mr. DeVries would review the records given to him by David, he would forward them to Mr. Saurman who would then compile the tax

return. Mr. Saurman was available throughout the investigation and at trial.

Appellant's tax returns for 1974, 1975 and 1976, respectively, reported taxable income of \$199,641.20, \$203,792.51, and \$186,122.84, with tax due of \$100,961.09, \$105,772.38, and \$100,179.19. Using the net worth method of determining income, IRS Agent Richard Sammut prepared a schedule, based on all available evidence, computing appellant's net worth for 1974, 1975 and 1976. After determining appellant's corrected taxable income, the government reduced it by the reported taxable income, and arrived at an understatement of taxable income upon which the potential tax due to the United States was \$83,635.73, \$30,378.20 and \$34,652.29 for 1974, 1975 and 1976, respectively.

In its summary schedule, the government had inserted a "dash" to represent the amount of inventory held by appellant as of December 31, 1973. Appellant contends that if the government had pursued the "lead" he had furnished regarding the existence of opening inventory in 1973, it could have negated his understatement of taxable income, or at least have substantially reduced it. Citing Holland v United States, 348 U.S. 121, 135-136 (1954), appellant argues that the government was obligated to investigate "relevant leads furnished by the taxpayer--leads reasonably susceptible of being checked, which if true, would establish the taxpayer's innocence." ^{1/}

^{1/} Appellant stated that the value of his inventory rarely exceeded \$125,000, and that since battery sales excelled in December, the value of inventory at year's end was generally less than that amount. Inventory held as of December 31, 1974 was valued at

The record amply supports the government's contention that it investigated the lead supplied by appellant. IRS Agent Robert Keller testified that appellant kept no records and admitted that there was no inventory for Solar Sales. Agent Keller went to Mr. DeVries' office to go over books and records in an attempt to establish an opening inventory for the other distribution business. His compilations were based on invoices from Michigan Natural Storage and on records obtained from Mr. DeVries. There were no records for 1973. Agent Keller

1/ \$99,858.68. Accordingly, even had appellant been credited with a maximum opening inventory of \$125,000, that would not have negated his understatement and would not have established his innocence.

explained:

"I did not include it -- we did not include it on our net worth statement, because we didn't know a value. We could not determine a value. We were not provided any invoices to show that these goods were purchased. We were not given any inventory records showing how many goods were in there and how much the value was, but he did offer to take us there and show us."

App. 139. Although Agent Keller stated at one point that he knew that there was inventory but did not know its value, he later testified that no records he saw indicated an inventory as of 1-1-74, a date which for tax purposes is used interchangeably with 12-31-73.

Agent Richard Sammut, testified:

Q You have a dash for '73.
What is that based on?

A Again the dash, there was not any evidence or any testimony that would reflect the dollar amounts or corroborate the dollar amounts of any type of inventory as of 12-31-73. The dash does not represent -- it could mean any amount.

It could be the same all through the four years. Some of the same theory of cash on hand. It just means that we don't know what it is, if there is anything there. What effect it would have on the net worth was not introduced. There wasn't any evidence or testimony to indicate it would produce any figures for that period, 12-31-73.

App. 207. Agent Sammut further testified that although appellant had a zero balance on his account payable to Michigan Natural Storage on 12-31-73, he had money due and owing for 1975-1976.

Robert Walker, IRS Special Agent with the Criminal Investigation Division, testified on cross-examination that he had asked appellant for records to establish inventory for 1973-1976, but appellant had only responded with an offer to take him to the warehouse. Walker declined for the obvious reason that inventory held as of 1980 would be

irrelevant to determining inventory held as of 1973. On redirect, Mr. Walker testified that he had contacted the owner-president of Michigan Natural Storage, reviewed its records, and obtained copies of invoices for 1974-76. He had contacted Meijer's and learned that the only records they maintained were the records of appellant's rental payments. Mr. Walker had requested that appellant turn over any available books and records, but none were tendered. Mr. Walker contacted A.E. Staley Co. regarding document purchases made by Battery Power Distributing. He also contacted Whitney-Fidelgo Seafood, but received only information regarding 1974. Accordingly, the government complied with the mandate of Holland v United States, supra, and investigated the "lead" supplied by appellant.

Many courts have iterated the general rule that in using the net worth method of computing taxable income, it is essential to establish an accurate net worth approximation at the beginning of the period for which the calculation is made. In United States v Gardner, 611 F.2d 770, 775 (9th Cir. 1980), the Ninth Circuit stated:

The net worth method of establishing taxable income may be employed if the prosecutor (1) accurately establishes the defendant's opening net worth, (2) identifies a likely source of taxable income from which it may be inferred that the defendant's increase in net worth arose, and (3) conducts a reasonable investigation of any leads that suggest that the defendant properly reported his income. (citations omitted) (emphasis added).

Precision in determining amount of understatement is not essential, however, particularly when the taxpayer's own record keeping deficiencies caused the government to rely on approximations of

opening net worth and inventory levels. Lee v United States, 466 F.2d 11 (5th Cir. 1972), on remand, 365 F. Supp. 389 (N.D. Miss. 1973). In United States v Stone, 531 F.2d 939, 941 (8th Cir.), cert. denied, 429 U.S. 824 (1976), the IRS had attempted to ascertain Stone's ownership of certain automobiles stored in a warehouse. The IRS attempted to obtain certificates of ownership from Minnesota state records, but the records had been destroyed. The Eighth Circuit stated:

In considering the appellant's contention that the evidence was insufficient to sustain a conviction on the net worth method of calculating taxpayer's income, we are mindful of the Supreme Court's admonition in Holland v United States, 348 U.S. 121, 75 S.Ct. 127, 99 L.Ed. 150 (1954), that the Government is required to establish "with reasonable certainty, *** an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets [and that] ***

the correctness of the result depends entirely upon the inclusion in this [net worth] sum of all assets on hand at the outset." Id. at 132, 75 S.Ct. at 134, 99 L.Ed. at 163.

The Holland court also noted the duty of the Government to investigate leads furnished by the taxpayer:

Here, Stone did not furnish the Government with any records of an actual automobile inventory. The Government reconstructed this inventory based upon the best information available.

In Schroeder v C.I.R., 291 F.2d 649 (8th Cir. 1961), cert. denied, 368 U.S. 985 (1962), the Eighth Circuit was faced with the task of estimating the cost of livestock on hand for the beginning of each year under investigation, where a physical head count of cattle was never made prior to the dates in question, no books were kept of the cattle feeding operations, and defendant's accountant previously had merely estimated the livestock carry-over each year. The

Commissioner adopted a method of calculating cost carried over into the succeeding year which defendant found objectionable. It was held that the Commissioner was not only justified in adopting this method but that petitioner's lack of records compelled it. Id. at 651.

- In net worth cases the fact finder is warranted in bearing heavily against the contentions of the taxpayer whose inexactitude is of his own making, and where the findings are based upon the entire record, they cannot be said to be clearly erroneous. Gatling v C.I.R., 4 Cir., 286 F.2d 139.

Schroeder, 291 F.2d at 653. The Ninth Circuit reached a similar result in Baumgardner v C.I.R., 251 F.2d 311 (9th Cir. 1957). There the taxpayer was a police officer with a fair education who held official positions in the community. The court held that when such a taxpayer chose not to keep books to record his

business transactions or preserve records and data from which exact computations could be made, that taxpayer had the responsibility for consequent lack of certitude in estimating his tax.

In the instant case, the government made a good faith effort to establish an opening inventory. It was Edward David's failure to keep accurate business records which prevented the government from obtaining an accurate evaluation of inventory held by David as of 12-31-73. Accordingly, appellant should not now be heard to object to the government's use of a "dash" in its computations.

Appellant also appeals the admission into evidence of the testimony of two government rebuttal witnesses, contending that the probative value of their testimony was outweighed by its prejudicial impact. This Argument is without merit. Appellant testified that

he had paid off his debts to Michigan Natural Storage. In rebuttal, for impeachment purposes, the government called Andrea Kragt, an office manager of Michigan Natural Storage, to testify that a civil suit had been instituted by her company to recover monies appellant had failed to pay. Similarly, appellant testified that he did not violate an agreement he had with Meijer's, though Meijer's had a claim against him for \$25,000. In rebuttal, for impeachment purposes, the government called Harvey Koetje, hardware buyer for Meijer's, to testify that Meijer's original claim against appellant was for \$50,000, but that Meijer's had agreed to settle for half that amount.

Although the testimony was prejudicial, it was highly probative on the issue of appellant's credibility. Questions of admissibility are within the

sound discretion of the trial court and will not be disturbed on appeal absent a showing of abuse of discretion.

Accordingly, the Judgment of the District Court is affirmed.

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 82-1493

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

EDWARD DAVID,

Defendant-Appellant.

Filed: January 27, 1983

Before: KENNEDY AND WELLFORD,
Circuit Judges; and BROWN, Senior Circuit
Judge.

J U D G M E N T

ON APPEAL from the United States
District Court for the Western District
of Michigan.

THIS CAUSE came on to be heard on the
record from the said District Court and
was argued by counsel.

ON CONSIDERATION WHEREOF, It is now
here ordered and adjudged by this court
that the judgment of the said District
Court in this case be and the same is
hereby affirmed.

No costs taxed.

ENTERED BY ORDER OF THE COURT
John P. Hehman, Clerk

By: (Mrs.) Dorothy Phelan
Deputy Clerk

Issued as Mandate: March 25, 1983

COSTS: NONE

A True Copy.

Attest:

Deputy Clerk

No. 82-1493

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

EDWARD DAVID,

Defendant-Appellant.

FILED: March 17, 1983

Before: KENNEDY AND WELLFORD,
Circuit Judges; and BROWN, Senior Circuit
Judge.

O R D E R

The Court not having favored rehearing en banc in the above case, the petition for rehearing is referred to our panel for disposition.

Upon consideration, it is ORDERED that the petition for rehearing be and hereby is DENIED.

ENTERED BY ORDER OF THE COURT

Clerk

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

UNITED STATES OF AMERICA,

Plaintiff,

vs.

EDWARD DAVID,

Defendant.

Docket No. G81-67 CR

JUDGMENT AND PROBATION/COMMITMENT ORDER

In the presence of the attorney for the government, the defendant appeared in person on this date, July 2, 1982, with counsel, Edward B. Goodrich.

Plea: Not Guilty.

Finding and Judgment: There being a verdict of guilty on all counts. Defendant has been convicted as charged of the offenses of attempt to evade or defeat income tax. Counts 1, 3 and 5 26 U.S.C. 7201; Wilfully making fraudulent tax return. Counts 2, 4 and 6 26 U.S.C. 7206(1).

Sentence or Probation Order: IT IS ADJUDGED that the defendant is hereby place on probation for a period of THREE YEARS, upon the following terms and conditions:

Defendant shall pay a Fine to the United States in the sum of Forty-Five Thousand Dollars (\$45,000.00).

The Fine shall be suspended if, within 30 days defendant shall remit to the Clerk of the Court \$45,000.00 which as the Court directs shall be placed in an interest bearing account to be used in a program which assists ex-offenders with job training. This \$45,000.00 shall not be used by the defendant as a tax deduction.

Defendant shall make a good faith effort to make a civil settlement with the Internal Revenue Service and pay the taxes found to be due. As to the amount due, defendant must enter into good faith negotiations with the Internal Revenue Service to reach a settlement.

Signed by U.S. District Judge Douglas W. Hillman.

Date: July 8, 1982.